No. .....

In the Supreme Court of the United States

F. H. Mason,
Petitioner,

vs.

C. F. Routzahn, Collector of
Internal Revenue,
Respondent.

PETITION FOR WRIT OF CERTIORARI
and
BRIEF IN SUPPORT OF PETITION.

S. M. Jett,
Horace Andrews,
Attorneys for Petitioner.

INDEX TO PETITION.

PETITION FOR WRIT OF CERTIORARI:

A. Summary of Facts 1

Stock Ownership and Dividend Distributions 3

Opinion of District Court 4

Decision of the Circuit Court of Appeals..... 6

Cases Cited in Petition.

Appeal of A. H. Stange, 1 B. T. A. 810 9

Appeal of Mary A. Fitzgerald, Doc. No. 810 (Decided October 26, 1926) Commerce Clearing House (1926 B. T. A. Service), Vol. 3, page 3389..... 9

Appeal of Maurice J. Curran, Doc. No. 793 (Decided Oct. 26, 1926) Commerce Clearing House (1926 B. T. A. Service), Vol. 3, page 3399 9

Boardman vs. Railway Co., 84 N. Y. 178 9

Brundage vs. Brundage, 60 N. Y. 544 9

Edwards vs. Douglas, 269 U. S. 204 .....2, 5, 10, 20

Eidman vs. Martinez, 184 U. S. 578, 583 10

Hopper vs. Sage, 112 N. Y. 530 9

Mason vs. Routzahn, 8th Fed. 2d, 56 (D. C.) 9

Matter of Kernochan, 104 N. Y. 618 9

Phillips vs. United States, 12 Fed. 2d, 598 9

Plant vs. Walsh, 280 Fed. 722 (D. C.) 9

Staats vs. Biograph Co., 236 Fed. 456, 458 9

United States vs. Guinzburg, 278 Fed. 366..... 9

United States vs. Merriam, 263 U. S. 179, 187-188 10

Wheeler vs. Northwestern Sleigh Co., 39 Fed. 347.... 9

INDEX TO BRIEF.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI:

Argument:

I. The Holding of the Circuit Court of Appeals that the Declaration of a Dividend by a Corporation Does Not Constitute a "Distribution" Within the Meaning of Section 31 (b) of the Act of 1917 is Contrary to the Holding of All Other Courts and Tribunals 14

II. The Circuit Court of Appeals Misconstrued Section 31 (b) as to the Meaning and Application of the Term "Most Recently Accumulated Profits and Surplus" as There Used 17

Cases Cited in Brief.

Appeal of A. H. Stange, 1 B. T. A. 810 16

Appeal of Maurice J. Curran, (Oct. 26, 1926) Commerce Clearing Housee, 1926 B. T. A. Service Vol. 3 page 3399 16

Appeal of Harmon W. Hendricks, (Sept. 30, 1926) 4 B. T. A. Service 3259, Commerce Clearing House, 1926 B. T. A. Service Vol. 3 page 3259; 16

Appeal of Harmon W. Hendricks, 4 Board of Tax Appeals, page 3251 (decided September 30, 1926) .. 19

Appeal of Mary A. Fitzgerald, (Oct. 26, 1926) Commerce Clearing House, 1926 B. T. A. Service Vol. 3 page 3389 16

Boardman vs. Railway Company, 84 N. Y. 178 15

Brundage vs. Brundage, 60 N. Y. 544 15

Eidman vs. Martinez, 184 U. S. 578, 583 18

Hopper vs. Sage, 112 N. Y. 530 15

In Matter of Kernochan, 104 N. Y. 618 15

Oklahoma vs. Texas, 47 Sup. Ct. Rep. No. 1, 9-16..... 21

Partington vs. Attorney General, 4 H. L. 100, 122 18

Phillips vs. United States, 12 Fed. 2nd, 598 16

Plant vs. Walsh, 280 Fed. 722 16

Smietanka vs. First Trust and Savings Bank, 257 U. S., 602, 605, 606 18

Staats vs. Biograph Co., 236 Fed. 456 15

United States vs. Guinzburg, 278 Fed. 366.....15, 16

United States vs. Merriam, 263 U. S. 179 17

Wheeler vs. Northwestern Sleigh Company, 39 Fed. 347 15

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PETITION FOR WRIT OF CERTIORARI.

To the Honorable The Supreme Court of the United States:

Your petitioner respectfully shows to this Court as follows:

A.

SUMMARY OF FACTS.

1. Your petitioner was, at the time of the commencement of this suit, and still is, a citizen and resident of the State of Ohio, and the respondent was and still is the Collector of Internal Revenue for the Eighteenth District of Ohio.

2. This is a petition for writ of certiorari to review the final determination of the Circuit Court of Appeals for the Sixth Circuit, made and entered on June 30, 1926, and a petition for rehearing overruled on October 7, 1926, reversing the judgment theretofore entered in the District Court of the United States for the Northern District of Ohio, Eastern Division, in which the petitioner was plaintiff and the respondent was defendant. A certified copy of the entire transcript of the record in the case, including the proceedings in the Circuit Court of Appeals and opinion of that Court, is furnished and filed herewith.

3. This case involves the construction of Section 31 (b) of the Revenue Act of 1917, which is as follows:

> "(b) Any distribution made to the shareholders or members of a corporation, join-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, etc."

This suit was begun to recover the sum of $12,458.60 of income taxes wrongfully exacted on corporate dividends received during the year 1917. Mason's return computed the tax at the 1916 rate,—because the dividend distributions in question were actually made from the 1916 surpluses of the Company. When the dividends in question were declared, and until after all of them had been paid, the corporation had no undivided profits or surplus for 1917. Nevertheless, the Department assessed the tax at the 1917 rate.

The District Court held that under Section 31 (b) of the 1917 law, the 1916 tax rate was applicable under the agreed facts. Judgment was entered in favor of Mason for the amount claimed with interest.

The decision of the Circuit Court of Appeals, reversing the judgment of the District Court, resulted from a misapprehension of the decision of this Court in *Edwards vs. Douglas*, 269 U. S. 204, based upon a single paragraph found in that opinion. As a result, the Circuit Court of Appeals misconstrued and misapplied Section 31 (b) of the Act of 1917.

STOCK OWNERSHIP AND DIVIDEND DISTRIBUTIONS.

4. Your petitioner owned and held prior to and during the years 1916 and 1917 shares of common stock and preferred stock of The B. F. Goodrich Company, a New York corporation, doing business in Ohio. Prior to January 1, 1917, this Company had accumulated in its treasury a large surplus arising out of its business, more than sufficient to pay all the dividends hereinafter referred to.

5. Dividends were declared and paid by The B. F. Goodrich Company to its common stockholders at $1.00 per share for each dividend, and to its preferred stockholders at $1.75 per share for each dividend, as follows, to-wit:

COMMON STOCK.

Date of Declaration	*Date of Payment*	*Received by Mason*
October 25th, 1916	February 15th, 1917	$22,781.00
January 24th, 1917	May 15th, 1917	22,781.00

PREFERRED STOCK.

Date of Declaration	*Date of Payment*	*Received by Mason*
October 25th, 1916	January 2nd, 1917	$17,517.50
January 24th, 1917	April 2nd, 1917	17,473.75
January 24th, 1917	July 2nd, 1917	17,473.75

(R. p. 3).

6. It is evident from the facts in the record, and was found by the District Court, that when these *dividends were declared* The B. F. Goodrich Company had no undivided profits or surplus for the year 1917. The District Court found it unnecessary to determine as to the earnings or profits of the Goodrich Company between January 24th and July 2, 1917, yet the record abundantly shows that the Company had no profits for the year 1917 until after all of the dividends here in question had been paid.

On January 28th, 1918, the Company sent notice to F. H. Mason, and to all its other stockholders, that—

> "The dividends on the preferred stock of this company which were paid on January 2nd, 1917, April 2nd, 1917, and July 2nd, 1917, and on the common stock which were paid on February 15th, 1917 and May 15th, 1917,—were declared from the net profits accumulated in the calendar year 1916, which were the most recently accumulated undivided profits of the company." (R. p. 13).

7. In his return for the year 1917, Mason reported the dividends here in question as paid from the surplus and profits of the Company for the year 1916; and paid the tax based upon that part of his income at the 1916 rates (R. p. 13).

The Treasury Department determined that Mason was not entitled to pay taxes upon dividends from the Goodrich Company during 1917, at the 1916 rates, but should be taxed thereon at the 1917 rates (R. pp. 13 and 14), and the Commissioner assessed additional taxes. On demand of the Collector, with threat of distraint (R. pp. 14 and 15) Mason paid such additional tax under protest, made claim for refund, which was rejected, and thereupon this suit was begun.

The case went to trial in the District Court and was decided on July 2, 1925 (R. pp. 22-26) (8 Fed. Rep. 2nd Series, page 56).

OPINION OF DISTRICT COURT.

8. In the opinion of the District Court, the following appears:

> "The solution of this dispute turns upon the proper interpretation and construction of Section 31, added October 3, 1917, to the Revenue Act of 1916 (R. p. 22)."

The Court in comparing the facts of this case with those in the case of *Douglas vs. Edwards* (R. p. 23) pointed out that in that case there were ample earnings for the year 1917 prior to the date of declaration out of which the distributions in question in that case could have been made, and then proceeded:

> "Here, part of the dividends were declared in October, 1916, the remainder were declared as early as January 24th, 1917. It is true the earliest payment was February 15th, 1917, and the latest July 2nd, 1917. The corporation, on making these declarations of dividend, recited and announced that they were a distribution of accumulated and undivided profits and surplus accruing during the year 1916. *It seems to me that this declaration is the only inference which may be legitimately drawn from the agreed facts.*" (Italics ours.)

The Court also said (R. p. 24):

> "A distribution by the corporation to the shareholders takes place when the declaration of the dividend is made, and not when the dividend is paid. The amount of the dividend, after the declaration, becomes the property of the shareholder. As between him and the corporation, the relation of debtor and creditor as to such dividend is at once created. If, after the declaration and before the payment, the shareholder dies or sells his shares, the dividend, in the absence of any stock report board rule or by-law to the contrary, passes to the executor or the purchaser. It is, in substance, a debt due from the corporation, payable in the future at the date specified. These principles are well settled and have been applied to dividends declared under the Income Tax Act of October 3rd, 1913, making the effective date of distribution the date the dividend was declared, and not the date when it was paid. See *United States vs. Guinzburg*, (2 C. C. A.) 278 Fed. 363; *Plant vs. Walsh*, (D. C.) 280 Fed. 722. In addition thereto, it is familiar law that a corpora-

tion cannot lawfully declare a dividend except from accumulated undivided profits or surplus in existence at the time such declaration is made * * *.

"All of these principles must have been within the knowledge and cognizance of the law makers when they phrased Section 31."

The Court further said (R. p. 25):

"I am content to dispose of this case on this ground: I agree that the word 'deemed' is to be taken in the sense of 'conclusively presumed.' If there are or have been accumulated undivided profits or surplus before the distribution is declared or, in other words, made, it will be conclusively presumed against the shareholder that the distribution is from those most recently accumulated; but it is essential that the existence of accumulated undivided profits or surplus should be shown. In this case the showing is to the contrary, and it is not necessary, in order to support this showing, that a finding should be made upon the question of law and fact propounded in the last paragraph of the agreed statement of facts. It may be, as is contended by defendant, the tire sales under the facts agreed were what in law is known as a sale or return, and not a bailment, or a consignment. *Even so, the showing is conclusive that on January 24, 1917, when the last dividend was declared, i. e., when the last distribution was made, there could not have been in existence accumulated undivided profits for any period later than the year 1916.*" (Italics ours.)

Judgment was rendered for the plaintiff for the amount prayed in the petition.

DECISION OF THE CIRCUIT COURT OF APPEALS.

9. This case was thereupon removed on writ of error to the Circuit Court of Appeals for the Sixth Circuit, and the judgment of the District Court was reversed (R. pp. 38-40) (13 Fed. Rep. 2d Series, page 702).

The Circuit Court of Appeals said (R. p. 38):

"Since this case was decided below, the Supreme Court's opinion in *Edwards vs. Douglas* has appeared, 269 U. S. 204. While upon its facts the present case can be distinguished from that one, yet we conclude that the general view of the purpose and construction of the law there stated by Mr. Justice Brandeis must be applied here, and this leads us to a reversal of the judgment below."

The Court also said:

"The court below concluded that the 'distribution' was made when the dividend was declared, segregated from the body of undivided profits, and became a debt from the company to the stockholder, which he could sell independently of the stock.

"That, as between the stockholder and the corporation and from many points of view, such a declaration is a distribution of profits, is indisputable, but this is a taxing statute, the dominant thought of which is that the citizen should suffer an annual burden upon his annual current income."

The Court then held that the declaration of a dividend does not constitute a "distribution" by a corporation within the meaning of Section 31 (b) of the Act and said:

"This brings us to the phrase 'most recently accumulated' profits. This may refer to any one of three kinds of profits. First, those which at the time of the dividend payment have been formally recognized and entered on the books as profits for a fixed period, and are normally destined to be paid out in dividends; second, those which in fact have then come into existence but have not been ascertained or stated on the books; third, those which are finally ascertained and entered as the profits for the entire year during which dividends are paid. The *first* construction must be rejected on the authority of *Edwards vs. Douglas.*

"The *second* is logically permissible, but is impracticable. Not only may profits seeming to exist in

July disappear before the end of the year, but it is often, if not typically, humanly impossible to determine with any accuracy in what months of the year the profits were made. To attempt to administer the law upon this theory would bring endless and hopeless confusion and disputes. A meaning which would inevitably make the law most difficult of application and in large degree unworkable ought not unnecessarily to be attributed to Congress.

"The *third* construction *can not be spelled out in the very words of the law;* but if the entire taxing year should be taken as a unit, as Justice Brandeis says should be done (probably as applied here meaning 1917) it is seen that when the return was made in March, 1918, the taxpayer knew that profits had been accumulated in 1917 from which all 1917 dividends could be paid; and it is not unreasonable to suppose that the 'most recently accumulated profits' are to be *judged from the end of the fiscal year* during which the income was received. We see no other construction which will furnish a common yardstick by which the tax can be measured in all cases; and we conclude that the principle on which *Edwards vs. Douglas* was decided requires us to adopt this third construction." (Italics ours.)

The judgment below was thereupon reversed, and the Court directed that judgment be entered in the District Court in favor of Routzahn, the plaintiff in error.

Thereafter, a petition for rehearing was filed (R. p. 41) but was denied (R. p. 57).

10. The decision of the Circuit Court of Appeals is erroneous in two important respects, in each of which it is contrary to principle and in conflict with the decisions of this Court and of all other courts:

1. It held that the *declaration of a dividend* does not constitute a "distribution" by a corporation within the meaning of Section 31 (b) of the 1917 Act.

This holding is in direct conflict with the decisions of other Circuit Courts of Appeals and Federal Courts, and with the decisions of the Board of Tax Appeals. *United States vs. Guinzburg,* 278 Fed. 366 (2d Circuit Court of Appeals): *Plant vs. Walsh,* 280 Fed. 722 (D. C.); *Mason vs. Routzahn,* 8th Fed. 2d, 56 (D. C.); *Phillips vs. United States,* 12 Fed. 2d, 598 (D. C.) (This case now pending for decision in the Third Circuit Court of Appeals); *Appeal of A. H. Stange,* 1 B. T. A. 810; *Appeal of Mary A. Fitzgerald,* Doc. No. 810 (Decided October 26, 1926) Commerce Clearing House (1926 B. T. A. Service), Vol. 3, page 3389; *Appeal of Maurice J. Curran,* Doc. No. 793 (Decided Oct. 26, 1926) Commerce Clearing House (1926 B. T. A. Service), Vol. 3, page 3399.

It is also in conflict with the general law which must have been in contemplation of Congress in adopting the Act. *Wheeler vs. Northwestern Sleigh Co.,* 39 Fed. 347; *Staats vs. Biograph Co.,* 236 Fed. 456, 458, especially the decisions of the courts of New York where the Goodrich Company was incorporated,—*Hopper vs. Sage,* 112 N. Y. 530; *Matter of Kernochan,* 104 N. Y. 618; *Brundage vs. Brundage,* 60 N. Y. 544; *Boardman vs. Railway Co.,* 84 N. Y. 178.

2. It adopted a construction of Section 31 (b) of the Act, which it stated "cannot be spelled out in the very words of the law"; and held that for the purpose of determining from what year's profits dividend distributions are deemed to have been made, the "most recently accumulated profits," as used in Section 31 (b), did not mean those of the current year which in fact had come into existence before or at the time of the dividend distribution; but that within the meaning of the law, the "most recently accumulated profits" are those which are *finally ascertained and entered* as the profits for the "entire year during which

dividends are paid," and are to be "judged from the end of the fiscal year during which the income was received," even though up to the time of the dividend distributions, there were no profits for that year.

This holding and determination is:

(a) In direct conflict with the decisions of this Court, that a tax law cannot be extended beyond the express words of the law, and that in case of doubt such a law must be construed against the Government and in favor of the taxpayer. *United States vs. Merriam,* 263 U. S. 179, 187-188; *Eidman vs. Martinez,* 184 U. S. 578, 583.

(b) In conflict with the express language, intention and meaning of Section 31 (b); and in conflict with the regulations of the Treasury Department under which most other taxpayers have been taxed.

(c) It also misapplies, misconstrues and is therefore in conflict with the decision of this Court in *Edwards vs. Douglas,* 269 U. S. 204, which held that "most recently accumulated profits" from which distributions are deemed to have been made, are not required to be those ascertained and entered in book accounts at the end of the year, but include current earnings.

11. Various cases are now pending in other Federal Courts awaiting the final determination by this Court of the questions here involved—so that until finally and definitely settled, like cases will be brought to the attention of the courts in various sections of this country, involving continued litigation.

From the foregoing, it is plain that this case involves questions as to which the decisions of the Federal Courts are in direct conflict. It also involves important questions affecting the public generally, by reason of which the questions here presented should be promptly determined by this

Court, to the end that the construction of Section 31 (b) and the rights thereunder of taxpayers be finally determined, so that a great amount of litigation and waste of time of the courts will be avoided.

WHEREFORE, your petitioner respectfully represents that the case is one of gravity, importance, and of general public interest, and your petitioner prays that a writ of certiorari be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Sixth Circuit, commanding said Court to certify and send to this Court on the date to be designated in said writ, full and complete certified transcript of the record of all proceedings in said Circuit Court of Appeals in this case, to the end that said case may be reviewed and determined by this Court, as provided by law, and that your petitioner may have such other and further relief and remedy in the premises as to this Court may seem proper.

F. H. MASON,
By S. M. JETT,
Of Counsel.

S. M. JETT,
HORACE ANDREWS,
Counsel for Petitioner.

STATE OF OHIO,
SUMMIT COUNTY, SS.

F. H. MASON, being first duly sworn says that he has read the foregoing petition and knows the contents thereof, and that the facts therein stated are true to the best of his knowledge, information and belief.

F. H. MASON.

Sworn to and subscribed before me this 13th day of December, A. D. 1926.

.....

Notary Public.

My commission expires .....

I hereby certify that I have examined the foregoing petition, and in my opinion the petition is well founded, and that the case is one in which the prayer of the petitioner should be granted by this Court.

S. M. JETT.

No. .....

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F. H. Mason,
Petitioner,

vs.

C. F. Routzahn, Collector of Internal Revenue,
Respondent.

BRIEF

In Support of Petition for Writ of Certiorari.

The judgment of the Circuit Court of Appeals is reported in 13 Fed. 2d Edition, page 702. Said judgment was filed on June 30, 1926 (R. p. 37); application for rehearing was filed August 7, 1926 (R. p. 41); order overruling the petition was filed October 7, 1926 (R. p. 57).

The questions considered in this brief relate to the decision of the Circuit Court of Appeals for the Sixth Circuit, in matters of general public importance relative to the construction of the Income Tax Law of 1917, affecting the rights of all taxpayers and the determination of many pending cases. It is in conflict with the terms of the law of 1917, and with the regulations and rulings of the Department, and is also in conflict with the decisions of other circuit courts of appeals, and of this Court, and with the weight of authority.

1. It held that while, between the corporation and its stockholders, the declaration of a dividend constitutes a "distribution" by the corporation, yet for tax purposes it does not constitute a "distribution" within the meaning of Section 31 (b) of the Act of 1917.

2. Said decision gives a construction to Section 31 (b) of the Act, which it states "cannot be spelled out in the very words of the law."

3. It held that dividend distributions declared in October, 1916, and January, 1917, which were actually paid in the months from January to July 2, 1917, when there were no profits of the Company actually in existence later than those of the year 1916, were nevertheless, deemed to have been made from 1917 profits which were earned in the latter part of the year 1917.

4. It held that within the meaning of said Section 31 (b) providing:

> "Any distribution made to the shareholders * * * of a corporation, * * * in the year 1917, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus,"

the "most recently accumulated profits" within the meaning of said section are those which "are *finally ascertained and entered* as profits for the entire year during which dividends are paid," and are to be "judged from the end of the fiscal year during which income was received."

ARGUMENT.

I.

THE HOLDING OF THE CIRCUIT COURT OF APPEALS THAT THE DECLARATION OF A DIVIDEND BY A CORPORATION DOES NOT CONSTITUTE A "DISTRIBUTION" WITHIN THE MEANING OF SECTION 31 (b) OF THE ACT OF 1917 IS CONTRARY TO THE HOLDING OF ALL OTHER COURTS AND TRIBUNALS.

Section 31 (b) in express terms, refers to "*any distribution* made to the shareholders * * * of a corporation * * *." This language is sweeping and without qualification.

That the declaration of a dividend by a corporation irrevocably creates an indebtedness from the company to its stockholders, is universally held by courts and text writers. Such indebtedness is severed from the shares of stock and may be sold or assigned, separated therefrom, from the time of the declaration forward.

Wheeler vs. Northwestern Sleigh Company, 39 Fed. 347, *Hopper vs. Sage,* 112 N. Y. 530, *In Matter of Kernochan,* 104 N. Y. 618, *Brundage vs. Brundage,* 60 N. Y. 544, *Boardman vs. Railway Company,* 84 N. Y. 178, *Staats vs. Biograph Co.,* 236 Fed. 456.

The Circuit Court of Appeals in its decision concedes that the declaration of a dividend does constitute a "distribution" from the corporation to the stockholder, and for other purposes. There is nothing in Section 31 (b) which narrows or limits the meaning of *"any distribution."*

That the declaration of a dividend constitutes a distribution to the stockholders within the federal tax laws, and within the provisions of Section 31 (b) of the Act of 1917, has been held by every other court or tribunal which has considered this question under Section 31 (b) down to the present time.

In *United States vs. Guinzburg,* 278 Fed. 366, the Second Circuit Court of Appeals dealt with a case where a dividend had been declared before March 1, 1913, but paid after that date. The Court in a learned opinion set forth the principles hereinbefore stated and held that the amount of the dividend became capital of the stockholder upon its declaration, and therefore, the stockholder was not subject to taxation under the Act of 1913, because he received payment after March 1, 1913.

In *Plant vs. Walsh,* 280 Fed. 722, the District Court decided the same proposition, following the holding in *United States vs. Guinzburg.*

In *Phillips vs. United States,* 12 Fed. 2nd, 598 (now pending in the 3rd Circuit Court of Appeals) the District Court held that the declaration of dividends constitutes a distribution under the Section 31 (b) of the Act of 1917.

In the *Appeal of A. H. Stange,* 1 B. T. A. 810, the Board of Tax Appeals in an exhaustive opinion, held that the declaration of a dividend constituted a distribution within the meaning of Section 31 (b). The Board of Tax Appeals has also recently decided at least three other cases, namely the *Appeal of Harmon W. Hendricks,* (Sept. 30, 1926) 4 B. T. A. Service 3259, Commerce Clearing House, 1926 B. T. A. Service Vol 3 page 3259; *Appeal of Mary A. Fitzgerald* (Oct. 26, 1926) Commerce Clearing House, 1926 B. T. A. Service Vol. 3 page 3389); *Appeal of Maurice J. Curran,* (Oct. 26, 1926) Commerce Clearing House, 1926 B. T. A. Service Vol. 3 page 3399;—in each of which cases, the Board of Tax Appeals held that the declaration of a dividend by a corporation constituted a distribution within the meaning of Section 31 (b) of the Act of 1917.

Thus it is sufficiently evident that the decision of the Circuit Court of Appeals in this case is in conflict with all the other holdings relative to this important question; and that it has created an uncertainty as to what constitutes a "distribution" within the meaning of Section 31 (b) of the 1917 Act.

The many cases which are now pending involving this question will come on for hearing in various courts, and will come to this Court unless this question is finally settled.

II.

THE CIRCUIT COURT OF APPEALS MISCONSTRUED SECTION 31 (b) AS TO THE MEANING AND APPLICATION OF THE TERM "MOST RECENTLY ACCUMULATED PROFITS AND SURPLUS" AS THERE USED.

The Record shows that The B. F. Goodrich Company had made no profits for the year 1917 prior to July 2nd of that year, and that in fact the most recently accumulated profits of the Company up to July 2nd were the profits and surplus of 1916, from which the dividends in question were actually made.

(a) The Circuit Court of Appeals construed Section 31 (b) relative to the meaning of the "most recently accumulated profits" as therein used, but stated that its construction *"can not be spelled out in the very words of the law."*

The bare reading of Section 31 (b) shows that the Court was correct in this statement. But this Court has many times held that a construction and meaning which is not found in the words of a tax law should not be adopted and can not be applied.

In *United States vs. Merriam,* 263 U. S. 179, this Court said in the opinion (page 187):

> "On behalf of the Government it is urged that taxation is a practical matter and concerns itself with the substance of the thing upon which the tax is imposed rather than with legal forms and expressions. But in statutes levying taxes, the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer. *Gould vs. Gould,* 245 U. S. 151, 153."

The Court then quotes and adopts the opinion of Lord Cairns in *Partington vs. Attorney General,* 4 H. L. 100, 122, which reads in part:

> "If the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown seeking to recover the tax *cannot bring the subject within the letter of the law,* the subject is free, however apparently within the spirit of the law the case might otherwise appear to be."

Eidman vs. Martinez, 184 U. S. 578, 583;
Smietanka vs. First Trust and Savings Bank, 257 U. S., 602, 605, 606.

(b) The holding that, for the purpose of determining from what year's profits a dividend distribution is deemed to have been taken, "most recently accumulated profits" within the provisions of Section 31 (b) did not mean those of the current year which in fact had come into existence before the dividend distribution,—is unwarranted.

It is contrary to the express language of the Act which provides that "any distribution made to the shareholders * * * of a corporation * * * shall be deemed to have been made from the most recently accumulated undivided profits or surplus, etc." As used in Section 31 (b), the "most recently" accumulated profits can have no other ordinary meaning than, *before or up to the time of such distribution.* It certainly cannot mean, *after* the distribution has been made. It has been the universal understanding of taxpayers, the Revenue Department and Board of Tax Appeals, as well as the courts, that "most recently accumulated" referred to a time prior to the distribution.

In Article 107 of Regulations 33, adopted January 3, 1918, this construction is found.

After giving the requirements of Section 31 (b), this regulation reads:

> "Thus if a corporation distributed dividends in 1917, such dividends will be deemed to have been paid from the earnings of 1917, and the recipient, if an individual, will be liable to additional tax, if any, and if a corporation to income tax, at the rates for the year 1917, unless it is shown to the satisfaction of the Commissioner of Internal Revenue, *that at the time such dividends were paid the earnings up to that time were not sufficient to cover the distribution,* in which case the excess over the earnings of the taxable year will be deemed to have been paid from the most recently accumulated surplus of prior years, etc."

On February 28, 1918, Treasury Decision No. 2759 was published and on March 28, 1918, Treasury Decision No. 2678 was published. In both of these decisions the construction of the law that most recently accumulated earnings would mean earnings up to the date of payment was announced.

In *Appeal of Harmon W. Hendricks,* 4 Board of Tax Appeals, page 3251 (decided September 30, 1926), the Board of Tax Appeals held that under Section 31 (b) of the 1917 Act, dividend distributions were to be deemed made from the earnings of the corporation made prior to the time of the distribution.

The decision of the Circuit Court of Appeals therefore, is in conflict with the regulations and rulings of the Treasury Department, and with the holding of the Board of Tax Appeals.

(c) The ruling that within the meaning of Section 31 (b) the "most recently accumulated" profits, are those which are "*finally ascertained and entered* as the profits for the entire year during which dividends are paid," and are to be "judged from the end of the fiscal year during

which the income was received,"—is also erroneous and unwarranted. Nothing in the act gives warrant to such a construction, and it is in plain conflict with the decision of this Court in *Edwards vs. Douglas,* 269 U. S. 204.

In *Edwards vs. Douglas,* the corporation had made profits for the year 1917 sufficient at all times to pay all dividend distributions and it was the sole claim of the taxpayer that within the meaning of the law, a surplus account or an undivided profits account, determined as of the end of the year, and entered on the books of the corporation, was contemplated and required by the Act; and that throughout the year 1917 the most recent surplus or undivided profits accounts *so determined and entered* were those of 1916.

Dealing with this claim, this Court expressly held that the law *did not* limit profits and surplus from which dividend distributions were deemed taken, to final entries upon books of account kept for that purpose, determined as of the end of the fiscal year; and held that within the intent of Section 31 (b) for the purpose of determining what were the "most recently accumulated" profits, current earnings were to be included and regarded. This determination was elaborately discussed in the opinion.

The conclusions announced by the Circuit Court of Appeals, were undoubtedly based upon one isolated paragraph in the opinion of Mr. Justice Brandeis, the meaning of which was misconstrued and misapplied, namely—

> "Its general aim was clearly to make the dividend, in whatever year paid, bear the *tax rate* of the year in which the profits of which it was a distribution had been earned, and for *this purpose* to treat as a unit the profits of the whole year." (Italics ours).

In other words, for the purpose of making all of the profits of any one year bear the same tax rate, it was the intention of Congress to treat as a unit all of the

profits earned during the whole tax year; and whenever any profits are distributed as dividends they shall bear the *tax rate* of the year in which they were earned.

It is one thing to treat as a unit the profits of a whole tax year for the purpose of determining the *tax rate* on such profits "in whatever year paid" as dividends. It is quite a different thing to treat such profits as a unit for the whole tax year for the purpose of determining what should be deemed to be the most recently accumulated profits of a corporation up to the time of a dividend distribution, even though no profits had been made to that time.

It is certain that neither Mr. Justice Brandeis nor the Court intended to say that a dividend distribution made early in 1917 when no 1917 profits existed, was to be deemed made out of 1917 profits earned in the last part of the year.

The decision of the Circuit Court of Appeals again illustrates the error, lately pointed out by this Court, of taking a single passage, without regard to the entire context and real holding of the opinion.

In *Oklahoma vs. Texas*, 47 Sup. Ct. Rep. No. 1, 9-16, this Court stated:

> "The effect of a decree as an adjudication conclusive upon the parties, is not to be determined by isolated passages in the opinion considering the rights of the parties, but upon an examination of the issues made and intended to be submitted, and which it was intended to decide. *Vicksburg v. Henson*, 231 U. S. 259, 272, 273, 34 S. Ct. 95, 58 L. Ed. 209; *United Shoe Mach. Co. v. United States*, 258 U. S. 451, 460, 42 S. Ct. 363, 66 L. Ed. 708."

Respectfully submitted,

S. M. Jett,
Horace Andrews,
Counsel for Petitioner.

No. 152

IN THE

Supreme Court of the United States

OCTOBER TERM, 1927.

F. H. MASON,

Petitioner,

against

C. F. ROUTZAHN, Collector of Internal Revenue for the Eighteenth District of Ohio,

Respondent.

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

TEXT OF:

Section 31, Revenue Act of 1917,

***Edwards* v. *Douglas*, 269 U. S. 204,**

***Appeal of Stange*, 1 B. T. A. 810.**

SECTION 31 OF THE REVENUE ACT OF 1917.

"SEC. 31. (*a*) That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association or insurance company, which stock dividend shall be considered income, to the amount of the earnings or profits so distributed.

(*b*) Any distribution made to the shareholders or members of a corporation, joint-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen."

EDWARDS, COLLECTOR, *v.* DOUGLAS ET AL., EXECUTORS.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

No. 129. Argued April 17, 1925.—Decided November 23, 1925.

Section 31 (b), added by the Revenue Act of 1917 to the Revenue Act of 1916, provides: "Any distribution made to the shareholders . . . of a corporation . . . in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, . . . but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen . . ." Construing this, *Held:*

1. Where the net profits of a corporation, during the fiscal year in which dividends are paid, are sufficient to cover such dividends, the term "most recently accumulated undivided profits" applies to such current earnings, and the dividends must be deemed to have made from them and are subject to the income tax rates of that year, although, when the distribution was made, there were other funds, adequate to meet it, carried in the surplus account of the corporation, as made up to the end of the preceding fiscal year. Pp. 207, 215, 217.
2. The term "surplus" as employed in corporate finance and accounting designates an account on the books, representing the net assets of the corporation in excess of all liabilities, including its capital stock. P. 214.
3. As used in § 31 (b) *supra*, "surplus" means that part of the surplus which was derived from profits, which, at the close of earlier annual accounting periods, were carried into the surplus account as undistributed profits. *Id.*

4. "Undivided profits" has not acquired a fixed meaning in corporate finance and accounting; in § 31 (b) *supra*, there is reason to conclude, it refers to profits which have neither been distributed as dividends nor carried to surplus account upon the closing of the books,—that is, to current undistributed earnings. P. 214.
5. The general aim of Congress, when enacting the above legislation, was to make the dividend, in whatever year paid, bear the tax rate of the year in which the profits of which it was a distribution had been earned, and for this purpose to treat as a unit the profits of the whole tax year; coupled with which was the special aim of making the war profits pay the high war taxes, to which end it was essential that the law, in determining the applicable tax rate, should neither accept any declaration of the corporation as to what year's profits were being distributed, nor adopt the earliest year (since March 1, 1913) of which there were accumulated profits available for distribution. P. 216.

298 Fed. 229, reversed.

CERTIORARI to a judgment of the Circuit Court of Appeals which reversed a judgment of the District Court adverse to the plaintiffs, Douglas et al., in their action to recover from the defendant Edwards the amount of an income tax assessment which they paid to him, as Collector, under protest. See 287 Fed. 919.

Mr. Alfred A. Wheat, Special Assistant to the Attorney General, with whom *Solicitor General Beck* and *Mr. Richard S. Holmes,* Special Assistant to the Attorney General, were on the brief, for petitioner.

Messrs. Matthew C. Fleming and *Paul Armitage,* with whom *Messrs. Archibald Douglas* and *Edward Holloway* were on the brief, for respondents.

MR. JUSTICE BRANDEIS delivered the opinion of the Court.

Section 31 (b), added by § 1211 of the Revenue Act of 1917, c. 63, Title XII, 40 Stat. 300, 338 to the Revenue Act of 1916, provides: "Any distribution made to the

shareholders . . . of a corporation . . . in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, . . . but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen. . . ."

James Douglas received from Phelps Dodge Corporation in September and December, 1917, two dividends, called at the time "depletion dividends," aggregating $328,400. He, and later his estate, claimed that these dividends were not taxable because they were a return of capital, not income. The Commissioner of Internal Revenue insisted that they were taxable, and assessed the tax at the 1917 rate. It amounted to $173,579.72. The estate paid the tax under protest, and brought, in the federal court for southern New York, this suit against the Collector to recover the full amount so paid. The contention was repeated that the dividends were not taxable because not constituting income. In addition it was claimed that, if they were taxable at all, it was not at the 1917 rate, but at the rate for 1916. The income tax rate imposed upon individuals for the calendar year 1917 by the 1917 Revenue Act was much higher than that imposed for the year 1916 by the Act of September 8, 1916, c. 463, Part I, 39 Stat. 756. The District Court concluded that the dividends were income and that they were taxable at the 1917 rate. It entered judgment for the Collector. 287 Fed. 919.

This judgment was reversed by the Circuit Court of Appeals. It agreed with the District Court that the dividends were not a distribution of capital. But it found

that there was on hand on December 31, 1916, in the surplus account, a balance of profits earned in that year amply sufficient to enable the corporation to pay these dividends out of such surplus; held that by reason thereof the dividends received by Douglas should have been taxed under § 31 (b) at the 1916 rate; and ordered that a mandate issue directing the District Court, upon a new trial, to enter judgment for the Douglas estate in accordance with its conclusions. 298 Fed. 229. This Court granted a writ of certiorari. 266 U. S. 596. The assertion of the estate that the dividends were a distribution of capital was not renewed in this Court; and the character assigned to the dividends by the corporation was treated here as of no legal significance. The sole question requiring decision[1] is whether these dividends paid in 1917 shall be deemed to have been paid out of the earnings of that year or out of an accumulated surplus built up in 1916 and earlier years. The question does not concern the corporation. The stockholder is interested only because he is an income tax payer.

The Government contends that the phrase "most recently accumulated undivided profits or surplus" in § 31 (b) includes current earnings of the year in which the dividends are paid; and that, as the earnings of 1917 were ample to pay these dividends, the 1917 dividends are conclusively presumed to have been paid out of 1917 earnings. The fiscal year of Phelps Dodge Corporation coincides with the calendar year. The corporation earned in 1917 a net profit of $16,742,487.06. The two distributions here involved amounted to only $3,600,000. The corporation paid from time to time during 1917, in all, ten

[1] The estate had also contended that the word "deemed" merely "gave rise to a rebuttable presumption, subject to be rebutted by showing the fund out of which the corporation actually paid the dividend." This contention was denied by both lower courts and was not made in this Court.

dividends aggregating $14,400,000. A large excess remained, to be added to the surplus account on closing the books as of December 31, 1917. There was no suggestion by the Douglas estate that, when these dividends were paid, the current undistributed 1917 earnings of the corporation then accrued were in fact insufficient to pay the two dividends. The District Court found that, under a *pro rata* apportionment, they were "more than sufficient." It is not suggested that the approximate amount of the undivided current earnings of 1917 accrued and undivided at the times these dividends were paid was not in fact known to be sufficient for this purpose. Nor is it suggested by the Douglas estate that the exact facts, or the knowledge thereof by the corporation at the times when the dividends were declared or paid, are of legal significance.

The claim of the Douglas estate is that the current profits are not, within the meaning of the Act, the "most recently accumulated undivided profits or surplus," from which the distributions "shall be deemed to have been made"; and that what Congress intended was that a dividend should be deemed to have been paid from the most recent accumulation of profits which, before payment of the dividend, appeared on the books as having been added to the undivided profits or surplus account of a fiscal year. The argument is that the income tax is levied generally with reference to the period of a full year; that the net financial results of the full calendar and fiscal year of a corporation cannot be known until the expiration of the fiscal year; that the words used by Congress have in corporate accounting a well known technical meaning; that this meaning is earnings which have been determined by the taking of inventories and the balancing of books to constitute "undivided profits or surplus"; that it was after December 31, 1917, before the net financial results of the operations of that year were formally and

definitely determined by this corporation by the usual taking of the annual inventory, the balancing of the books, and the carrying of the "undivided profits or surplus" to the appropriate account; that the most recently accumulated undivided profits so appearing was the undistributed balance of the profits earned in the year 1916, which was shown on the books as closed under date of December 31, 1916, and appeared in the surplus account; that this balance was sufficient in amount to meet these two dividends; and that it must be deemed to have been applied in paying them. In short, the claim of the Douglas estate is that Congress, in providing by § 31 (b) that dividends shall be deemed to have been paid "from the most recently accumulated undivided profits or surplus," meant from such balance as, at the time of the payment of the dividend, is shown by the undivided profits or surplus account of the preceding fiscal year.

The Douglas estate, apparently, does not contend that under the 1917 Act dividends are not to be taxed at all unless there was an existing balance of taxable profits in the surplus or undivided profits account from which they can be considered to have been paid. To have so contended would have been to impute to Congress the intention of exempting from taxation the dividends received in 1917 by those individuals who were stockholders in corporations which earned in 1917 large sums and paid them out in dividends during that year,[2] but which had no earned surplus at the close of their fiscal year on De-

[2] This, as a business matter, could easily be done, and is, in fact, done by many corporations. Nearly every business with a well developed accounting system can, at any time, without the formal periodic inventory or closing of its books usual at the end of a fiscal year, determine approximately the amount of its current earnings, the amount accrued since the beginning of its fiscal year, and the part thereof undistributed. Many corporations do make such approximate ascertainment of profits monthly, or oftener. And, relying upon their system of cost-accounting, they make distributions of current

cember 31, 1916, or whose earned surplus consisted wholly of profits earned prior to March 1, 1913. The Douglas estate grafts upon the section an implied condition or limitation. Its position seems to be that § 31 (b) applies if, and only if, at the time of the payment of the dividend, there was on hand an undistributed part of the taxable earnings of some prior fiscal year or years. In other words, it asserts that Congress, in providing that a distribution to shareholders should "be deemed to have been made from the most recently accumulated undivided profits or surplus," implied the condition—"if there are such accumulated profits or surplus not exempt from taxation"; that if there are available no such undivided profits or surplus, accrued subsequent to March 1, 1913, the distribution will be considered to have been made from current earnings; that such dividends, in that event, would be taxable as income under § 2 (a) of the Revenue Act of 1916, 39 Stat. 757, as amended by § 1200 of the 1917 Act, 40 Stat. 329; and that the 1917 rates would apply. Whether, at the time these 1917 dividends were paid, there was in the surplus account as of December 31, 1916, such funds sufficient for their payment, as the Court of Appeals appears to have found, we have no occasion to consider. For we are of the opinion that, in any event, the District Court was right in holding that these 1917 dividends must be deemed to have been paid out of the 1917 earnings, and that the stockholder was taxable thereon at the 1917 rate.

The legislative history of § 31 (b) is relied upon by the Douglas estate in support of its construction. On

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earnings without a closing of the books, as the Phelps Dodge Corporation did in 1917.

This is shown by the record to be true of the Phelps Dodge Corporation. It paid during 1917 regular and extra dividends on June 28, on September 28, and on December 28, aggregating $8,100,000, which were declared, in its report to stockholders, to have been paid by it "out of earnings for the year 1917."

the other hand, the Government relies upon the legislative history of the Revenue Act of 1918, Act of February 24, 1919, c. 18, 40 Stat. 1057, passed by the same Congress which enacted the Revenue Act of 1917. Enquiries into the detail of legislative history are sometimes helpful in removing a doubt presented by the language used in a statute. *Penn Mutual Life Ins. Co.* v. *Lederer,* 252 U. S. 523, 537. But we have no occasion here to resort to that aid in construing the phrase in question. To ascertain its meaning, we need only bear in mind the general character of the income tax, the specific practices of corporations concerning profits and dividends, the prior income-tax legislation, to which § 31 (b) is an amendment, and the time of the latter's enactment.

Ordinarily, an income tax is laid upon all taxable income actually received during the tax-year and the tax is payable at the tax-rate of the year in which it is received, although none of the income may have been earned by the taxpayer during that year, or, where the income consists of dividends, although the corporation may not have earned in that year any part of the profits of which the dividend is a distribution. The Act of October 3, 1913, c. 16, § II, 38 Stat. 114, 166, the first income-tax law enacted after the adoption of the Sixteenth Amendment, was construed by the Treasury Department as embodying this general rule without any exception. Consequently, the Treasury enacted such payment on account of all income received by the taxpayer after March 1, 1913, the effective date of the Amendment, although it appeared that all of the income had been earned before that date either by the taxpayer or by the corporation whose profits were distributed as a dividend. The correctness of the Treasury's construction was questioned; and before the second income tax law was enacted, September 8, 1916, c. 463, Title I, 39 Stat. 756, lower federal courts had in *Lynch* v. *Hornby,* 236 Fed. 661, held the Treasury

construction to be erroneous. There had also been serious contention that, as construed by the Treasury, the provision was, when applied to dividends, both unconstitutional and unjust.[3] These contentions apparently prevailed with Congress when, in framing the 1916 Act, it raised the normal tax-rate from 1 per cent. to 2 per cent. and the maximum additional tax (super-tax) from 6 per cent. to 13 per cent. The 1916 Act, by a proviso to § 2, limited the tax on dividends to distributions "made or ordered to be made by a corporation . . . out of its earnings or profits accrued since March first, nineteen hundred and thirteen . . ." Soon after came the War; the great need of the Government for large revenues; and the large war-profits. Congress enacted the 1917 War Income Tax Law, which raised the normal tax rate to 4 per cent. and the maximum additional tax to 63 per cent.; and it made the provision retroactive, in the main, to January 1, of that year.

While the 1917 Act was under consideration, it was recognized that this rapid increase in the income tax rate might result in unjust discrimination if no change were made in the then existing rule governing the taxation of dividends. All profits earned by members of a partnership would be taxed at the rate prevailing in the year in which they were earned, although actually withdrawn in a later year when the tax rate was much higher. On the other hand, the tax upon the profits of a corporation earned in 1916 or earlier, would, if paid out in 1917 as dividends, be taxed at the high 1917 rates. There would be similar discrimination among the holders of stock in different corporations. The stockholders in those corporations which had deferred the distribution of profits

[3] The decision of this Court of *Lynch* v. *Hornby*, 247 U. S. 339, which sustained the Treasury's construction and held the act constitutional, was not rendered until June 3, 1918. See also *Peabody* v. *Eisner*, 247 U. S. 347.

earned prior to 1917, either generally from prudence or specifically with a view to stabilizing over a long period the rate of dividend, would be at a great disadvantage as compared with the stockholders in those corporations which had pursued the practice of distributing each year substantially all profits earned. On the other hand, if corporations were left free to determine out of what year's profits dividends paid in 1917 and subsequent years should be deemed to have been made, a corporation with a surplus derived from earnings made prior to 1917 could, while accumulating the profits of the war years, pay dividends on which its stockholders would escape the heavy war tax, by simply declaring that the dividends were payable out of the earnings of earlier years. And if there were still on hand such sufficient surplus earnings from the period prior to March 1, 1913, the dividends would be exempt from all tax. It was apparently to obviate such inequalities that Congress provided by § 31 (b) for an objective consideration of the date when the corporation earned the profits, as well as the date when the taxpayer received his share of them in the form of the dividend. By implying the condition stated above, the Douglas estate escapes from a position which would otherwise impute to Congress the intention of enabling the war profits of 1917 and subsequent years, actually distributed as dividends, to escape from the war taxes. But in implying the condition it imputes to Congress, which was seeking to prevent discrimination against stockholders in those corporations which had on January 1, 1917, surplus profits earned since March 1, 1913, the intention of grossly discriminating in their favor. For if this condition is read into the Act, stockholders in corporations which had no such surplus on December 31, 1917, are taxable on 1917 dividends at the high 1917 rates; while those in corporations which had such surplus are taxable on 1917 dividends at the lower rates of 1916 or earlier years.

Congress did not use the words "surplus account" or "undivided profits account." Its language is "undivided profits or surplus." The word "surplus" is a term commonly employed in corporate finance and accounting to designate an account on corporate books. But this is not true of the words "undivided profits." The surplus account represents the net assets of a corporation in excess of all liabilities including its capital stock. This surplus may be "paid-in surplus," as where the stock is issued at a price above par. It may be "earned surplus," as where it was derived wholly from undistributed profits. Or it may, among other things, represent the increase in valuation of land or other assets made upon a revaluation of the company's fixed property. See *La Belle Iron Works* v. *United States,* 256 U. S. 377, 385. As used in § 31 (b) the term undoubtedly means that part of the surplus which was derived from profits which, at the close of earlier annual accounting periods, were carried into the surplus account as undistributed profits. On the other hand, the term "undivided profits" has not acquired in corporate finance and accounting a like fixed meaning. It is not known as designating generally in business an account on the corporation's books, as distinguished from profits actually earned but not yet distributed.[4] Few business corporations establish an "undivided profits" account.[5] By most corporations the term "undivided profits" is employed to describe profits which have

[4] The Committee on Accounting Terminology of the American Association of Public Accountants was for years engaged in preparing a list of definitions. That contained in the Year Book of 1913, pp. 176-227, gives at p. 226 this definition: "Undivided Profits—Earnings or profits which have not been divided among the partners in a firm or the stockholders in a corporation."

[5] The Interstate Commerce Commission prescribes for the various classes of corporations subject to its supervision about 13 different forms of accounts, all of which include a general balance sheet. The number of items on the liability side of this balance sheet varies in

neither been distributed as dividends nor carried to surplus account upon the closing of the books; that is, current undistributed earnings.

That this is the natural meaning of the term "undivided profits" is indicated by the action of both Douglas and his estate.[6] That this is the meaning in which it was used by Congress is confirmed by the use of the expression "earnings and profits" later in the same paragraph,[7] and, also, by the use of the term "undivided profits" in § 207.[8] If it be accepted as the meaning in which Con-

these several forms from 8 to 33. There is no item "undivided profits" in any form.

By incorporated banks the term is commonly employed to designate the account in which profits are carried more or less temporarily, in contradistinction to the account called surplus in which are carried amounts treated as permanent capital, and which may have been derived from payments for stock in excess of par, or from profits which have been definitely devoted to use as capital. See *Fidelity Title & Trust Co.* v. *United States*, 259 U. S. 304, 308.

[6] Douglas received (see note 2, *supra*) from Phelps Dodge Corporation during 1917 six other dividends, aggregating $738,900, which were confessedly paid out of the 1917 profits—and which were reported by him as taxable in his return to the Commissioner of Internal Revenue. The two dividends here in question were reported by him in his return as not taxable solely on the ground that they were "depletion dividends." It was on this ground only that the estate, in its applications to the Treasury, sought recovery of the amount in suit.

[7] § 31 (b) " . . but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen."

[8] In § 207 of the same Act, which deals with the War Excess Profits Tax on corporations and makes the tax dependent on the amount of the invested capital, the term "undivided profits" is likewise used.

gress used the words, the course to be pursued under § 31 (b) becomes consistent with the general purpose evidenced by other parts of the Act. Its general aim was clearly to make the dividend, in whatever year paid, bear the tax rate of the year in which the profits of which it was a distribution had been earned; and for this purpose to treat as a unit the profits of the whole tax year. In providing measures for the attainment of that aim, it could be of no practical significance whether, at the time of the payment of the dividend, these profits appeared in a surplus or undivided profits account (as the profits earned within part of a year would, where a corporation closed its books monthly, quarterly, or semi-annually) or whether they still rested as current earnings without formal determination or specific allocation.

Besides this general aim, Congress had the special aim of making the war profits pay the high war taxes.[9] To this end it was essential that the law should, in determining the applicable tax rate, disregard any declaration of the corporation as to what year's profits were being distributed. Not only was it essential that every such declaration of the corporation should be disregarded, but also that the dividend should not thereupon be deemed to have been paid from the profits of the earliest year (since March 1, 1913) of which there remained accumulated

That section, in paragraph (a) 3 defines invested capital as including "paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year."

[9] To discourage the hoarding of profits in order to avoid the tax, two supplemental provisions were incorporated in the Act. By § 3, incorporating § 3 of the Revenue Act of 1916, Congress taxed as income received by the stockholder his proportion of profits earned by the corporation and fraudulently hoarded by it to avoid payment of the tax. By § 1206 (2), adding § 10 (b) to the Revenue Act of 1916, it subjected the corporation to an additional tax of 10 per cent. on undistributed income not employed in the business, unless invested in obligations of the United States.

profits available for distribution. To accomplish the purpose of Congress it was necessary that the dividend be deemed to have been paid out of the available profits or earnings of the most recent year or years. Its intention so to provide was adequately expressed by the use of the phrase "most recently accumulated" in connection with the words "undivided profits or surplus." As, in the case at bar, there were profits of the year 1917 ample to cover all dividends, those here in suit must be deemed to have been paid therefrom.

Reversed.

MR. JUSTICE VAN DEVANTER, MR. JUSTICE MCREYNOLDS, MR. JUSTICE SUTHERLAND, and MR. JUSTICE BUTLER, dissent.

Appeal of A. H. STANGE. Docket No. 553.

A resolution of the board of directors of a corporation directing that a surplus fund be placed to the credit of the stockholders, "to be paid to the stockholders when and as directed by the officers or directors," constitutes a dividend at the time the resolution was passed.

A dividend declared by a corporation in 1917, prior to August 6 of that year, out of a surplus existing at March 1, 1913, is not taxable to its stockholders as income even though the corporation had earrnings or profits in the years in which payment was made out of which the dividend could have been paid.

The Board has no jurisdiction to consider an appeal filed by a taxpayer on behalf of other taxpayers similarly situated, who do not join in the appeal.

Submitted January 21, 1925; decided March 18, 1925.

W. W. Spaulding, Esq., and *Allen R. Smart, C. P. A.*, for the taxpayer.

A. Calder Mackay, Esq., for the Commissioner.

Before IVINS, KORNER, and MARQUETTE.

This is an appeal by the taxpayer from a determination of the Commissioner proposing to assess additional taxes for the years 1918 and 1919. From the stipulation of facts presented at the hearing the Board makes the following

FINDINGS OF FACT.

The A. H. Stange Co. is a corporation the entire capital stock of which is held by the taxpayer herein and nine other members of his family. On January 27, 1917, the board of directors of the A. H. Stange Co. passed a resolution as follows:

Whereas, * * * prior to the enactment of the Federal Income Tax Laws our mill and factory plant account which for a number of years had been carried at the nominal sum of $25,000 * * * and

Whereas, in order to establish a proper basis of accounting due to said loss, it was necessary to raise the value of our mill and factory plant from $25,000 to a fair value of $150,000, as shown by entry on our books under date of February 13, 1912, and

Whereas, said increased valuation was on said date erroneously credited to "surplus account," be it

Resolved, That we charge "surplus account" with the said sum of $125,000 and place this amount to the credit of the stockholders, to be paid to the stockholders when and as directed by the officers or directors, and the Secretary is hereby instructed to have proper entries made on the books of the company under date of January 27, 1917, to conform herewith.

On said 27th day of January, 1917, there was credited to the account of each of the stockholders of the said A. H. Stange Co. his proportionate share of the said dividend, and the amount of the dividend was actually paid as follows:

Aug. 8, 1917	$14,000
Sept. 5, 1917	21,000
Nov. 20, 1918	49,000
Jan. 13, 1919	41,000
Total	125,000

For the years from 1913 to 1917, inclusive, the gains and losses of the A. H. Stange Co. were as follows:

	Loss	*Gain*
1913	$19,710.14	
1914	133,600.10	
1915	136,628.55	
1916	21,284.32	
1917		$41,590.24

In the years 1918 and 1919, the corporation had earnings and profits sufficient to pay the amounts actually paid in those years. The Commissioner proposes to tax the amounts actually paid in each of the years as dividends in those years, upon the ground that the corporation had sufficient earnings and profits in each year out of which such distribution could have been paid, and upon the further ground that the resolution declaring the dividend provided that it was to be paid when and as directed by the officers and directors of the corporation.

DECISION.

The determination of the Commissioner is disapproved and the Board determines that no part of the dividend de-

cleared on January 27, 1917, is taxable to the taxpayer herein as income. The amount of the deficiency to be assessed will be settled on consent or on seven days' notice under Rule 50.

OPINION.

MARQUETTE: The question for decision herein is whether the dividend declared by the directors of A. H. Stange Co. on January 27, 1917, is exempt from taxation as income to its stockholders, or whether it is taxable to them in the years in which it was actually paid. The taxpayer contends that, as the dividend was declared prior to August 6, 1917, out of earnings or profits accrued prior to March 1, 1913, it is not taxable income to him, irrespective of the fact that at the time it was paid the corporation had earnings or profits out of which payment could have been made.

The position of the Commissioner is that the words *any distribution made*, as used in the Revenue Acts of 1917 and 1918 with respect to dividends, has reference to the time of payment, and, as the corporation had sufficient earnings or profits in each of the years in which payment was made out of which such payment could have been made, the statute conclusively presumes that the distribution was made from those earnings or profits.

Section 31 of the Revenue Act of 1916 (added by section 1211 of the Revenue Act of 1917), relating to dividends, is as follows:

Sec. 31. (a) That the term "dividends" as used in this title shall be held to mean any distribution made or ordered to be made by a corporation * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, * * *.

(b) Any distribution made to the shareholders or members of a corporation * * * in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation * * *, but nothing herein shall be construed as taxing any earnings or profits accrued

prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed * * * exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. *This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen.* (Italics ours.)

The pertinent parts of the Revenue Act of 1918 are as follows:

Sec. 201. (a) That the term "dividend" when used in this title * * * means (1) any distribution made by a corporation * * * to its shareholders or members, whether in cash or in other property * * * out of its earnings or profits accumulated since February 28, 1913, * * *.

(b) Any distribution shall be deemed to have been made from earnings or profits unless all earnings and profits have first been distributed. Any distribution made in the year 1918 or any year thereafter shall be deemed to have been made from earnings or profits accumulated since February 28, 1913, * * *; but any earnings or profits accumulated prior to March 1, 1913, may be distributed in stock dividends or otherwise, exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed.

It is not disputed that at March 1, 1913, the A. H. Stange Co. had undivided profits or surplus in the amount of $125,000, or that a resolution of the board of directors of that company was passed on January 27, 1917, purporting to distribute that surplus to its stockholders. A question preliminary to the main issue has been made to the effect that, as the resolution provided for payment "when and as directed by the officers or directors," it did not become a dividend until the time for payment was fixed. We think this contention is without merit. It appears to be well settled that a dividend belongs to the holders of the stock at the time it is declared and not at the time it becomes payable; that, in the absence of special circumstances, a provision postponing payment or making it payable on the order of the board of directors does not change the rule, and it becomes payable within a reasonable time. *Wallin* v. *Johnson City Lumber & Mfg. Co.*, 188 S. W. 577 (Tenn.); L. R. A. 1917 B, 323.

In *Northwestern Marble & Tile Co.* v. *Carlson,* 116 Minn. 483; 133 N. W. 1014, the board of directors of a corporation adopted a resolution "that a dividend of 6 per cent be declared on the common stock, payable * * * at such time as the finances of the firm will in the judgment of the board of directors warrant." The contention was that the resolution did not constitute a valid dividend so as to make it available to stockholders. The court said:

> If the resolution is to be construed as claimed by the plaintiff, its adoption was either an idle ceremony, for the amusement of the stockholders, or a device to inflate the selling price of the stock. Neither inference is justified by the facts. The board of directors by the resolution declared a dividend, and its action was amply justified by the surplus and undivided profits of the corporation. No further action of the board was necessary to make the segregation of the amount of the dividend of each stockholder from the common mass of the corporate property. There was no qualification of the declaration of the dividend, and its existence as a debt against the corporation was not dependent upon any further action of the board, but the debt was payable at such time as the finances of the corporation would in the judgment of the board of directors warrant. This provision as to the time of payment of the dividend must be construed in connection with the fact that a dividend had been rightfully declared and notice thereof given to the stockholders at their annual meeting. So construing the provision, we hold that the time of payment of the dividend was not a matter depending upon the discretionary future action of the board, but that it gave to the board a reasonable time in which to make the necessary arrangements for its payment; that is, the dividend was payable within a reasonable time.

See also *United States* v. *Guinzburg,* 278 Fed. 363; *Plant* v. *Walsh,* 280 Fed. 722.

From the above authorities we are of opinion that the resolution of the board of directors of A. H. Stange Co. of January 27, 1917, constituted a valid declaration of a dividend at that time, even though the payment was to be made when and as directed by the officers or directors.

The determination of the principal question herein depends, in the last analysis, upon the construction which must be given to the words *any distribution made,* as used in section 31 (b) of the Revenue Act of 1916. If these

words have reference to the declaration of a dividend, the taxpayer must prevail; if they mean the actual time of payment of a dividend, then it will be necessary to construe the limitations upon distribution of earnings and profits in said section. It is therefore necessary to ascertain the legal effect of a resolution declaring a dividend. The definition of a dividend in section 31 (a) of the 1916 Act as "any distribution made or ordered to be made by a corporation * * * out of its earnings or profits * * * and payable to its shareholders," comports with the general definition of a dividend, and for the purposes of this case may be taken as correctlly defining a dividend declared out of earnings or profits accrued prior to March 1, 1913. What, then, is the legal effect of the declaration of a dividend? We think the answer to this question is clearly set forth by the court in *United States* v. *Guinzburg*, 278 Fed. 363, wherein the court said:

> By the declartion of a dividend, the earnings of the company to the extent declared were separated from the property of the corporation, and were appropriated by that action to the then stockholders, who became creditors of the corporation for the amount of the dividend. The relation then created was that of debtor and creditor. *N. Y. Trust Co. et al.* v. *Edwards, Collector*, 257 U. S. 176, 42 Sup. Ct. 68, 66 L. Ed. 186, decided November 21, 1921; *Wheeler* v. *Northwestern Sleigh Co.* (C. C.) 39 Fed. 347; *People ex rel. U. S. Trust Co.* v. *Barker*, 86 Hun, 131, 33 N. Y. Supp. 388; *Billingham* v. *Gleason Mfg. Co.* 101 App. Div. 476, 91 N. Y. Supp. 1046, affirmed 185 N. Y. 571, 78 N. E. 1099. It is the separation of the earnings from the balance of the corporate property, together with the promise to pay arising from the declaration of the dividend, that works this change. The holder of stock, with respect to the dividend, is on a par with the other creditors of the corporation. *Staats* v. *Biograph Co.*, 236 Fed. 454, 149 C. C. A. 506, L. R. A. 1917 B, 728. The fact that the dividend is payable at a future date does not alter the rights thus created. The obligation of the corporation as debtor commences with the declaration of the dividend, although the payment is postponed for the convenience of the company. The rights of the stockholders are immediately vested the moment the dividend is declared. *N. Y. Trust Co.* v. *Edwards, supra.* The action of the board of directors is the appropriation of a portion of the earnings to the defendant in error as the holder of a certificate of stock.

See also *Plant* v. *Walsh*, 280 Fed. 722; Fletcher, Enc. Corps., sec. 3653.

The outstanding features of a dividend declaration are that, by the mere declaration, the dividend becomes thereby separated and segregated from the stock and exists independently of it; the *right* thereto becomes immediately fixed and absolute in the stockholders, and the corporation becomes a debtor to its stockholders for their pro rata shares. There is an apportionment or division of the assets of the corporation, to the extent of the dividend, to its stockholders. The corporation is at once poorer in the amount of the dividend declaration, and the stockholder becomes richer in his own right, to the extent of his pro rata share. What theretofore existed as undivided profits or surplus has become divided profits and the surplus is reduced to the extent of the dividend declared. It has ceased to be the property of the corporation and has become the property of the stockholder, and his interest therein becomes adverse to the corporation and to every other stockholder. We think this division or segregation of the amount of the dividend from the general mass of the corporate property and its apportionment to the stockholders is included in the words *any distribution made*, as used in the statute, and that those words must be given the same legal effect as results from the declaration of a dividend. It follows that the resolution of the board of directors of A. H. Stange Co., passed on January 27, 1917, constituted a distribution to its stockholders at that time of the surplus existing at March 1, 1913, and the fact that payment was made in subsequent years becomes immaterial.

It remains to apply the provisions of section 31 (b) of the 1916 Act. By that section any distribution made in the year 1917 or subsequent tax years is deemed to have been made from the most recently accumulated undivided profits or surplus, and the presumption thus raised has been held to be a conclusive presumption. *Harder* v. *Irwin*, 285 Fed. 402; *Douglas* v. *Edwards*, 298 Fed. 229. The facts herein show that A. H. Stange Co. had operated at a loss in all the years from 1912 to 1917, and there were no un-

divided profits since 1913 out of which a distribution could have been made, and this appeal could be sustained on that ground. We prefer, however, to rest our decision upon the last sentence of section 31 (b), providing:

> This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen.

Holding, as we do, that the words *any distribution made*, as used in the statute, include the declaration of a dividend and must have the same legal effect; and the dividend in question having been declared prior to August 6, 1917, to wit, on January 27, 1917, the presumption that the distribution was from the most recently accumulated undivided profits or surplus has no application to the facts in this appeal. We are of opinion that the distribution made by the A. H. Stange Co. to its stockholders on January 27, 1917, out of a surplus existing prior to March 1, 1913, is exempt from taxation to the taxpayer herein at the time of the actual payment, and the determination of the Commissioner proposing to tax the same in the years in which it was paid must be disapproved.

A question presents itself from the face of the petition herein which was not raised by the Commissioner; but as it relates to the jurisdiction of the Board, we feel it is our duty to take notice thereof. The taxpayer has filed a petition on behalf of himself and nine other named persons, all stockholders of the A. H. Stange Co., in which it is stated that "the issue in the case of each stockholder named is identical, which is the reason for filing one petition and asking only one hearing." The petition is not a joint petition of all the named parties, and is the petition of this taxpayer alone. We know of no authority in the law, and there is certainly none in the rules of the Board, sanctioning or permitting an appeal by one taxpayer for or on behalf of another, even though they are all stockholders in the same corporation and the same question would be raised in an appeal prosecuted by them. The statute authorizes an appeal by the *taxpayer* within 60 days after the deficiency notice is mailed, and the Board has re-

peatedly held that the filing of a petition with the Board within that time is a jurisdictional matter. *Appeal of Sam Satovsky,* 1 B. T. A. 22. We therefore decline to express any opinion on the merits of the pretended appeals filed by this taxpayer on behalf of the nine other stockholders named in his petition.